DOW THEORY LETTERS INC.

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36 Letters per Year—$60.00 Annually

Registered with the Securities Exchange Commission

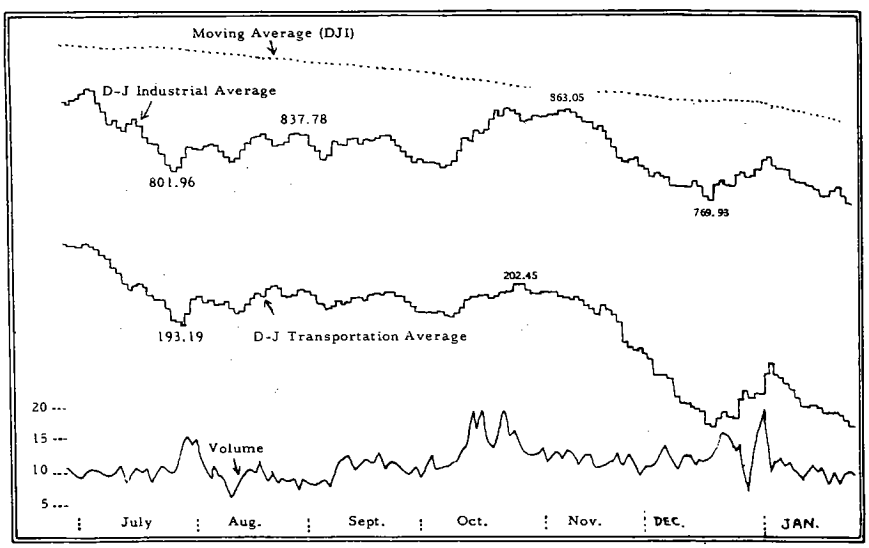
January 28, 1970 Letter 451

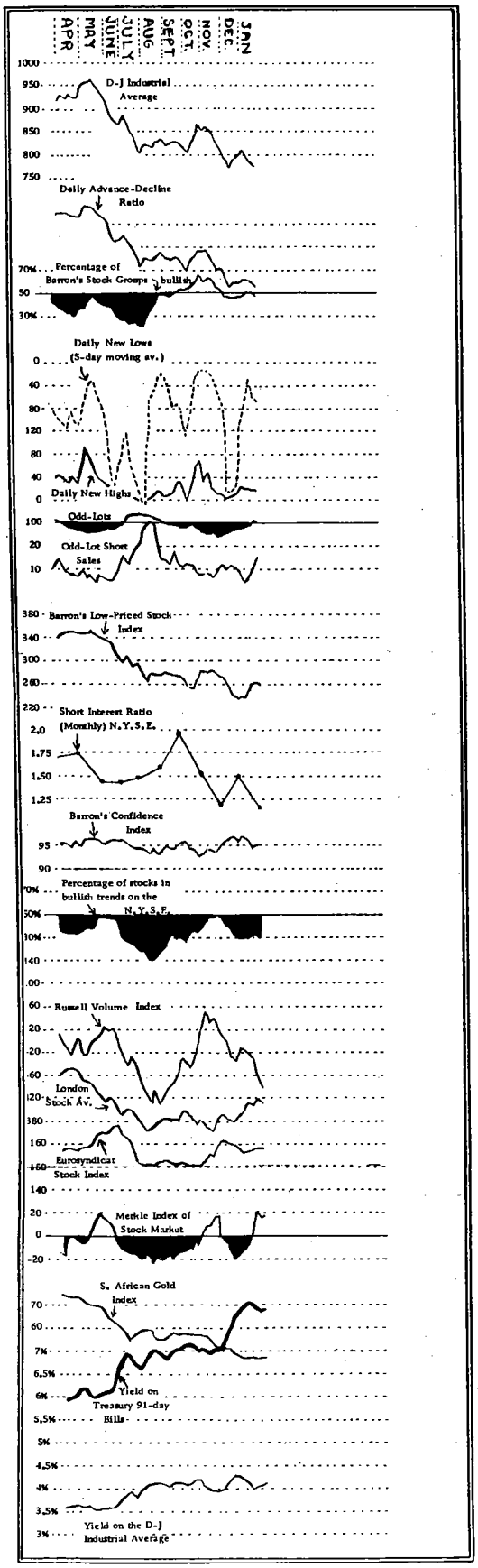
THE MARKET: During December the consumer price index rose at a 7.2% rate, up from a 6% pace in November. In perhaps the understatement of the year, the Wall Street Journal (Jan. 20) reported, "The consumer price rise picked up extra speed in December, causing Nixon Administration economists to strain for a favorable interpretation."

The irony of the situation might best be illustrated when, on January 19, it was announced that housing starts had dropped 4% in December, and on the same day (as if living in a different world) Bethlehem Steel and other companies raised prices on plate and structural steel 5% (the raise would affect roughly 35% of the steel industry's shipments).

The word I have coined for today's situation is "economic-schizophrenia." It is as if the consumer and the production indexes are living in one world and the price and profits indices are living in another world. A sort of arrogance bordering on insanity seems to have overtaken the nation's business. New York subway fares (remember the sacred 5¢ fare?) jumped from 20¢ to 30¢, transportation workers are asking a 75% (no misprint) increase over the next three years, GE workers are out on a disastrous strike which has lasted over three months, other huge labor-management confrontations are scheduled for 1970, and in the meantime auto sales are sagging, production schedules are being cut back, business sales were off in November, factory orders eased in November, retail sales in December barely topped November sales.

The fact is that the economic situation is becoming grim. In recent Letters I have outlined the almost frightening liquidity situation in this nation, I have tried to explain what could happen when a business slowdown occurs in the face of a dangerously low corporate liquidity structure. If business is indeed now in the process of contracting, I would expect corporation after corporation to run into financial trouble and to take drastic action to try to meet that trouble. As friend Eliot Janeway noted in a recent report, we are coming to the point where the corporations need the cash more than the stockholders. When that happens (and it is now happening) one prescription is dividend cuts. Consequently, I am suggesting that dividend cuts and omission are going to be the order of the day during 1970.



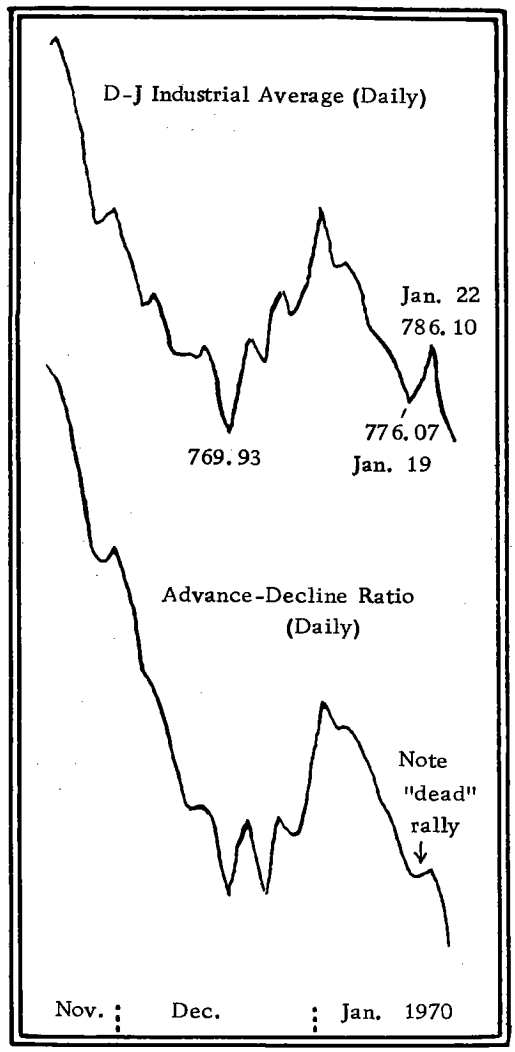


Meanwhile, back at the Government, I have no doubt that the dilemma has gone far past the point of being amusing. On the actual record, hardly a dent has been made in inflation. The Fed has its choice of recognizing reality, or responding to the pressure from business and those in the Administration who are afraid of a business slowdown. But if the original thinking behind the Fed policy of a money squeeze and high interest rates was to halt inflation, then the Fed lacks any logical reason to ease up on money now.

The Administration itself, in an honest attempt to cut expenses and perhaps provide something approaching a balanced budget, has announced large cuts in the armed services, a 50,000 man cut in the NASA payroll, and a $1 billion cut in purchase plans for the F-111. But looming around the corner is the spector of a decline (and perhaps a very large decline) in Government tax receipts via lower personal income and lower corporate profits. Should a recession arrive in 1970, the resultant drop in the tax take would produce Federal deficits perhaps greater than anyone now imagines.

To turn to Wall Street itself, the biggest technical news of the week was the 3 million share drop in the short interest, bringing the total from 16.8 million shares short to 13.9 million shares, the lowest level in almost three years. The drop jibes with my own observations in recent Letters to the effect that there is a decided lack of bearishness in the market (particularly in the face of the huge losses suffered during 1969).

Over the shorter term, events are moving so fast that I am confining late comments to the end of this Letter. However, it is clear that the mass of stocks on the N.Y.S.E. failed miserably on the January 20 to 22 rally from 776.07 to 786.10. On those three days, a total of only 79 more stocks advanced than declined. On January 23 the Dow responded to this very poor rally attempt by reversing and dropping over 10 points. The January 23 drop took the advance-decline ratio (see chart) to a new low for the entire bear market! Monday, January 26, saw the decline continue with joint penetration (i.e. both Averages) of the December lows a distinct possibility (see end of Letter).



Two other bearish technical phenomena have appeared to plague the market. First, odd-lotters switched to the buying side during last week's action, as odd-lot short sales continued to hold in a relatively low area. Second, the short interest ratio on the N.Y.S.E. dropped to a neutral (and near bearish) reading of 1.13. More significant, I have just received word from friend Bill Gordon in New York that the short interest ratio for the 30 Dow stocks dropped in December to .55, lowest reading since July, 1968, and the third lowest monthly reading in history (going back to 1931!). Thus, it can be said that the technical position of the Dow is ominously bearish.

With all the rapid near-term action, I am afriad that most observers lose sight of the big picture, and here it is— as I see it. A primary bear market began on February 9, 1966. On October 7, 1966, primary low points were established by the Industrial and Rail (now Transportation) Averages at 744.32 and 184.34 respectively.

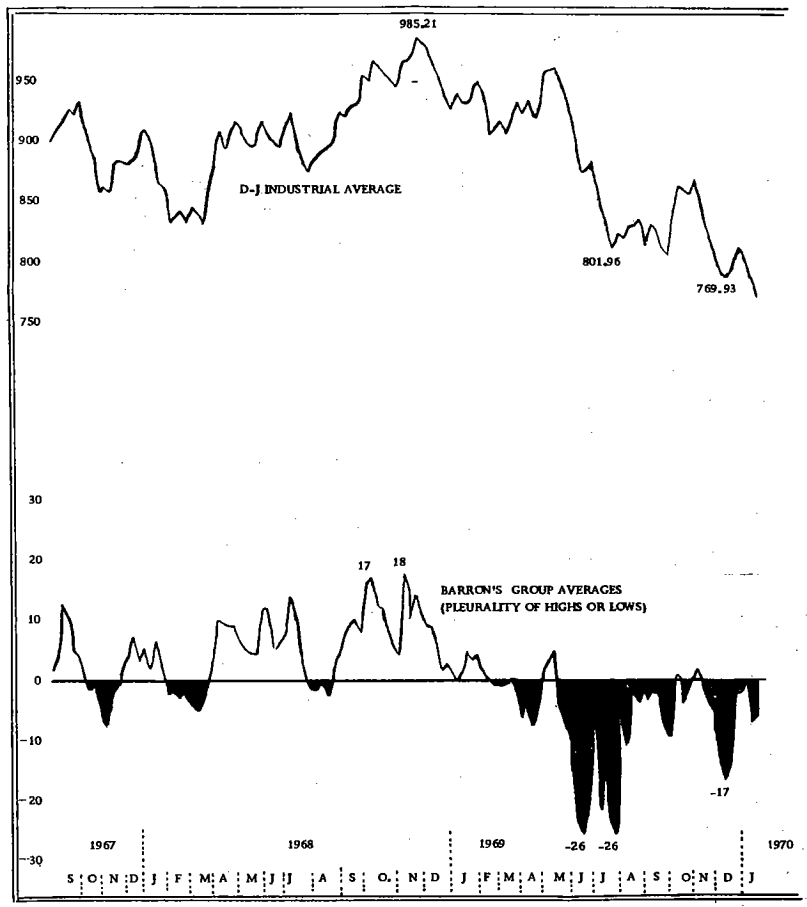
After an extended and speculative upward correction which lasted to December, 1968, the Averages again turned down. By late 1969 the Transportation Average provided its half of a signal for the re-confirmation of the primary bear trend by penetrating the 1966 low. The Industrial Average, although trending lower, did not confirm (i.e., did not penetrate the 744.32 level).

On December 17, 1969, Industrials recorded a low close of 769.93. A rally followed, and by January 5, 1970, the Industrial Average had recovered to 811.31. A new decline carried Industrials back to 776.07 on January 19. From the standpoint of the big picture, two levels on the downside are now of importance. The first is the December, 1969 low of 769.93. The second is the 1966 low of 744.32. If the bear market is still in force (and I firmly believe it is), then it is only a matter of time before those two levels are cracked. If and when that happens, the bear market will be reconfirmed.

Once the reconfirmation occurs, it will be a question of how much longer and lower to the final bottom. Personally, I have no preconceived idea of how much lower the Averages will sink. But all my studies indicate that the third psychological phase of the bear market still lies ahead. The third phase is the liquidation phase, and my own guess is that the Dow will ultimately lose as much (or more) during the third phase as it will lose during the first two phases. Again, as a guess, I would say that

the Dow is very apt to terminate the bear market in a zone somewhere below 500.

HEAVY GROUPS: In the last report I published my "bullish percentage" chart, showing that the bullish percentage of all N.Y.S.E. stocks, the Dow stocks and all stock groups were providing a picture of general market weakness. I am now going to up-date another study, a study first introduced in Letter 440.



This index is the count of groups which record new highs and new lows according to the weekly tabulations on the "Market Laboratory" page of Barron's. The study is arrived at as follows, the groups making new highs are subtracted from the groups making new lows (or vice versa if there are more highs than lows) and this figure is merely entered on the chart. For instance, if on a given week 14 groups make new lows and 4 groups make new highs, a minus 10 is entered on the chart. If 3 groups make new highs during a week and 3 groups make new lows, a zero is entered on the chart. (Note: Barron's places an H next to each group making a new high, an L next to each group making a new low).

The chart shows the group high-low index from the end of 1967 to the present. As seen on the chart, 1969 provided a very poor profile on this chart. During that year the group index went plus for a short time during January, again for three weeks during May, and finally for two weeks during late October and early November.

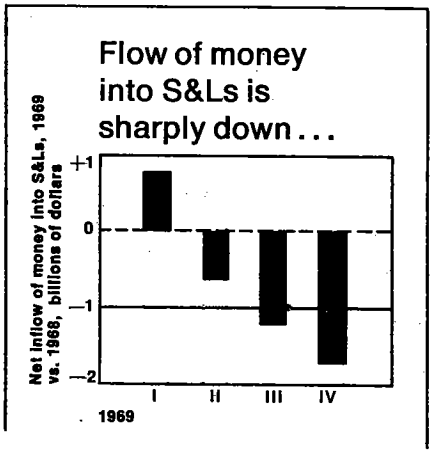
The lows for 1969 were recorded with a minus 26 in mid-June and another minus 26 during late July. The December low provided a "negative kind of hope" since the index only dropped to minus 17, although the Dow sank below its earlier July low. The best reading since the December, 1969 low, was zero on the week ending January 9. To me, this constituted a negative showing for the late-December early January rally, since the index was below the November peak of plus 3 but more importantly because the index failed to go plus at all.

On the week ending January 16 the index took a turn for the worse, dropping to minus 7. The January 23 week ended at minus 6. It will be interesting to see whether the December low of minus 17 will be surpassed during any weak periods ahead. If so, we will know that the bear market is raging in full force.

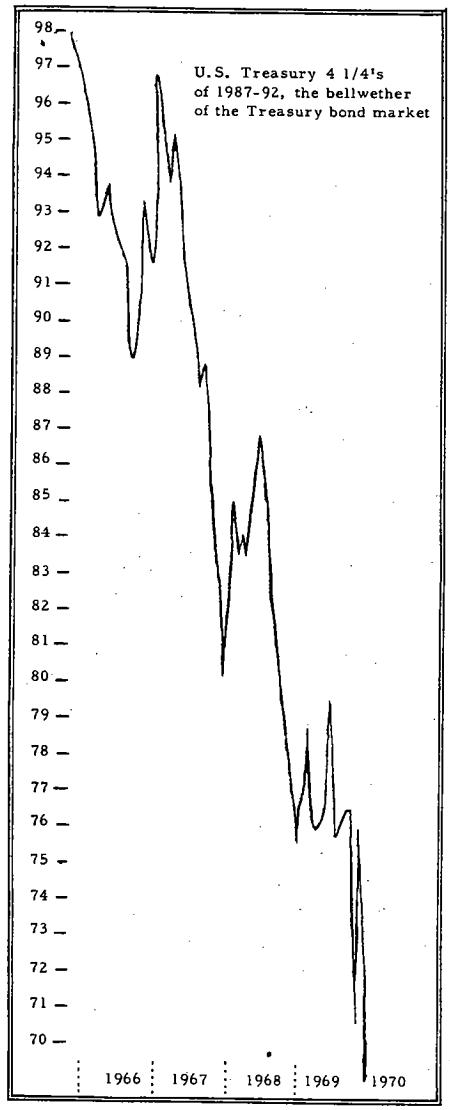
DIS-INTERMEDIATION: All last year I warned about the collapsing bond market and its certain-to-happen effects on the economy. Now its happening. The page 4 chart is an up-to-date picture of one of the most drastic collapses in the history of the bond market. It shows the bellwether $4\frac{1}{4}$ of 1987-92 Treasury issue, which came to the market in 1962. This issue has the longest maturity of any Treasury issue with the $4\frac{1}{4}$ ceiling coupon allowed by law. Here we see the famous $4\frac{1}{4}$, selling for 70¢ on the dollar.

At that price it yields a relatively risk-free 6.85% to buyers. That's the long-term debt picture on Treasury debt. Over the short term a buyer can get almost 8% on his money via 91 or 181-day bills. Historically, individual investors have purchased less than a fifth of the new bill issues. Last week, however, the figures indicated that the public was learning what it was all about. Individuals purchased one-third of the weekly offering of 91-day bills and half of the 181-day bill offerings.

Where is the money coming from for the offering of Treasury bills? It's coming in large part from saving and loan accounts and from savings bank accounts. When we consider that 60% of new-home financing comes from these sources, we can see what's occurring in the housing market. The S & L's and savings banks are not only running out of new money for housing, they're losing money on balance.



The smaller chart on this page from the late issue of Business Week illustrates what I am saying. Starting in the second quarter of 1969 the S & L's started losing money on balance. During the last quarter the losses became an avalanche. The savings banks fared just as badly, with December, 1969 bringing a record net outflow of $250 million. If this picture continues, the housing industry is in for major trouble during 1970.



THE GOVERNMENT'S JOB: A subscriber from Sunnyvale, California sent me this poem (bottom of page) last week. The poem carries a ligitimate complaint to the point of extreme bitterness and absurdity. I have often been asked about my opinion of the Government's role in social welfare, and here goes a bit of it.

There are those hard-noses who believe that the U.S. should return to the Adam Smith form of laissez-faire government. Personally, I want no part of the system of the 1870's, as far as Government's responsibilities go. Perhaps the powers above have allowed me to see both sides of the question from an emotional standpoint. I have three daughters. I have been told that two of them are extremely intelligent. My middle daughter is schizophrenic, she is 11 years of age and has never uttered a word and cannot take care of herself.

In 1870 my middle daughter might have ended her years in a "house of bedlam" or perhaps wandering like an animal through the refuse heaps of America. Thank God those days are passed. Yet I have often thought that if just a part of the money which has been spent on the F-111 had been spent on research for mental health, my daughter might conceivably be sane today.

I truly believe that the Government should be concerned with human welfare, with research which will improve and sustain the health of its citizens, with institutions to care for those who are unable to care for themselves, with the rehabilitation of human wrecks, with laws which will safeguard its citizens against practices which harm the health and safety of its people.

I also think it would be nice if the Government could guarantee prosperity, full employment, a job for every man and woman. But I don't think it can be done under this system. Furthermore, under the guise of a "chicken in every pot," I think the Government is fully as capable of doing as much harm as good. When the Government interferes with free markets because some industry desires protection, I feel that its efforts are useless if not harmful in the long range. If the Government floods the nation with fiat dollars in order to keep the nation "prosperous," I think it is in reality undermining the economic system.

I am all for an adequate defense system in the U.S. And I mean it. I well remember my frustration (and fear) at the sluggishness of our B-25's during World War II, and as a bombardier I would have given anything for more speed over the bomb-run. A nation needs excellent weapons for defense, at least in the world of today. But at the thought of the Government using its arms industry as

Modern Psalm

The government is my shepherd
Therefore I need not work;
It alloweth me to lie down on a good job
It leadeth me beside the still factories
It destroyeth my initiative;
It leadeth me in the path of the parasite
For politics' sake.
Yea, though I walk in the valley of laziness and deficit spending
I will fear no evil
For the government is with me;
It prepareth an economic Utopia for me
By appropriating the earnings of my grandchildren;
It filleth my head with false security
My inefficiency runneth over;
Surely the government shall care for me all the days of my life
And I shall dwell in a fool's paradise forever.

an instrument to sustain the prosperity of the country, I am apalled. If a nation needs to produce and export billions of dollars worth of arms to stay prosperous, I say the devil with that level of prosperity.

In short, I believe the Government belongs in the business of research for human welfare, I believe the Government should not allow the sick, the infirm or the weak to be uncared for, I believe that the Government should provide an adequate defense system to protect this nation (not to be confused with a defense industry as an instrument of full employment and as a bastion of prosperity).

I am against the Government manipulating free markets because those markets are "too high or too low." I am against the Government attempting th legislate perpetual prosperity because the Government hasn't got the vaguest idea of how to do it (and neither do I). This may sound heartless, but I am against the Government and the politicians being in the "prosperity business." This economic system, to my mind, has run a long time despite the interference of Government and politics, and anything which restricts the natural flow of free markets will, in time, produce a situation which is far more serious than the normal (although occasionally painful) cyclical pattern which has marked American growth since its inception.

NOTES & QUOTES: A letter received from my famous economist friend Eliot Janeway provides an interesting departure from my own views. Janeway agrees with me about the bear market, but he disagrees about the direction of the economy. He writes: "Just read yours of January 7, and hasten to respond by enclosing the Cleveland Press account of my January 9 speech to the City Club there. Rinfret is right. Recession is not the danger. Because it isn't, a money panic is." (my note: The article referred to, indicates that Janeway thinks a money panic will arrive in 1970, and that it may drive the Dow to around 600. Janeway likened the situation to the conditions which brought on the Panic of 1907).

Janeway's letter continues: "Where I think you are being beguiled is on the point that a change in psychology will be what is needed to deliver the coup de grace to the market. No matter what happens, blacks on relief and ethnics who are electricians will remain better credit risks than our best banks, and the market will be broken. When it is, the pressures to which it caves will be those of arithmetic, as in the past."

My comment: I don't doubt that Janeway is right about the money panic, and I agree with him that a money panic alone is certainly capable of breaking the stock market. However, I simply do not envision the economy holding up under the strains of what I see ahead. Perhaps my variation with Janeway regarding what is coming up stems from my appraisal of forthcoming public psychology. I foresee a broad swing in psychology toward pessimism, a loss of faith by the public in the Government, and a corresponding cut-back in consumer purchasing. I'll admit that what I see may not become obvious until late-1970 or even 1971, at which point the Government may have "goofed-up" enough to bring Janeway to my point of view.

* * * *

Perhaps adding some support to my view is a speech given by Mr. Lief Olsen, senior vice-president and economist for the First National City Bank in a speech before the Financial Analysts of Philadelphia. I include a few excerpts at the left.

* * * *

In an interview with Eliot Janeway, Sander Landfield (partner in the firm of Carlisle De Coppet & Co.) and a leading odd-lot expert discussed the changing market situation. Landfield noted that the odd-lot public is throwing its money to the institutions, and that odd-lot volume, which was 22% of total N.Y.S.E. volume in 1959, is now running at an all-time low rate of 8.5% of total N.Y.S.E. volume. This phenomenon, thinks Landfield, has served to make the market illiquid. There simply isn't enough "public" in Wall Street. "The higher the market," commented Landfield, "the greater its need for broad public participation. You need a mass market in order to turn over blocks on today's scale without causing excessive erraticism in

The implications of a deterioration in profits have been overlooked, for the most part, in the discussions regarding continued price inflation and plant and equipment spending. The latest Commerce-SEC plant and equipment survey taken in late November and early December indicated that businessmen planned to increase their capital outlays in 1970 by 9.7% over 1969, compared with an 11.2% rise from 1968 to 1969. However, we know from past history that actual plant and equipment outlays fall far short of planned targets when the economy slides into a recession. While technological change plays a major role in corporate investment, the rate of growth in orders and sales, cash flow, profits and profit expectations still represent the major forces determining the timing and the amount of spending. Moreover, the average rate of capacity utilization in manufacturing is already low. Large corporations, to be sure, have long-term ongoing capital programs. But even here, if things get bad enough, cost cutting takes top priority to preserve profits.

Total corporate profits have declined for 12 months now. All the evidence available suggests the decline in the fourth quarter spread to more industries. A rising number of companies are now lowering their capital spending targets for 1970.

Furthermore, the last time profits peaked as monetry restraint pulled down volume of sales was in 1966, and I noted earlier it took two years to get back to that peak level. The present restraint is more severe, and it is running longer.

price movements. But all year long, big block sales, most negotiated off the floor, have been undermining the market. This explains why we've suffered so much erosion on such small volume.....The public has outsmarted the managers. Professionals must now unload on professionals."

* * * *

Mr. Leonard Santow of Aubrey G. Lanston & Co. is one of the nation's leading technical economists. I thought his comments in the Weekly Bond Buyer (Jan. 12) interview were acute. Mr. Santow stated: "Quite frankly, 1970 will probably turn out to be the weakest year for business in over a decade.....The main reasons for the weaker picture are a poor model year for autos, major strikes throughout the economy, a sick housing market with little resiliency to bounce back quickly, declining corporate profits throughout the most if not all the year, and a need for many institutions to put their liquidity positions and financial houses in order before renewing major expansion plans."

"Moreover, many corporations are in need of permanent working capital, some may find they are overbonded, and others find they are already using close to the limits of their bank lines and still have unsatisfied needs. While liquidation of some debt may in fact be needed, the trend is decidedly and may frighteningly be in the other direction."

Massive Soviet slowdown hinted

By Paul Wohl
Written for
The Christian Science Monitor

It is becoming clear that not only the Soviet economy but also the country's whole administrative system are headed for a shakeup.

such a mess. And production failures and a slow rate of growth are only part of the picture. (Mr. Baibakov admitted that in 1969 industrial growth was the slowest in well over a decade.)

The big issues are demoralization of officialdom. a devil-may-

Kazakhstan is the Soviet Union's biggest copper producer —there is one boss for every two or three workers.

Livestock and poultry numbers have declined drastically in the past four years. "In all districts, and especially around the republic capital of Alma

Entire installations have come to a standstill "for long periods," both speakers complained. Rail transportation growth is stalled. Capital construction lags, cost estimates have been exceeded to a very large extent, investments are directed toward superfluous

The primary trend is always international in scope. When a major bear market is in force, its effects blanket the economies of the world. For this reason I was interested in this headline from the Jan. 17 Christian Science Monitor. It is the story of rising economic trouble in Russia. In an unpublished speech, General Secretary Brezhnew described a large part of Russia's workers in terms of "irresponsibility, waste and drunkeness." In Kazakhstand, Russia's second largest Republic, half of all the workers changed their jobs in 1969. Evidently economic inefficiency is rampant with rails stalled, agricultural produce lagging, and inflation in wages outrunning productivity.

In Canada, the worst agricultural conditions since 1932 prevail. Roughly 1.5 billion bushels of wheat are unsold, and in predominatly agricultural Saskatchewan net farm income dropped 30% in 1969. Badly hurt also are the provinces of Alberta and Manitoba. While Ottawa's Government wrestles with inflation, the provinces of the west are heading into depression.

* * * *

For the historical scrapbooks, I have included the most-active list for Jan. 19. Here we see the three most active stocks giving up a whopping total of 38.75 points for the day. It could be a while before we see this record surpassed, and I thought it was worth noting.

MOST ACTIVE STOCKS

NEW YORK (AP) — Sales, closing prices, net change in most active stocks:

Jan. 19, 1970	Total Sales	Last Sale	Net Change		Total Sales	Last Sale	Net Change
Telex Corp	162,300	128	+11⅞	Chrysler	75,300	30⅝	— ½
IBM	137,200	350	—19¾	Allied Strs	74,800	24¾	— ⅞
Polaroid	114,000	111⅝	—7⅛	Varian Asso	71,900	25⅛	—1½
Lowenstn	104,900	18¾	— ¾	Sperry Rnd	68,100	35⅜	— ¾
Sbd Wld Air	103,400	10¼	—1⅜	Armco pf wl	64,700	27⅛	+ ⅛
Lums Inc	87,100	13⅜	—1¼	Am Stand	63,100	30⅛	—1⅜
SCM Corp	84,100	20⅞	—1¾	City Invest	62,800	23	.....
Am Tel Tel	78,700	49	— ½				

LATE NOTES: On Monday, January 26, the Industrial and Transportation Averages simultaneously closed below their December 17, 1969 lows. Robert Rhea, the great Dow Theorist, always accorded particular importance to movements which resulted in simultaneous penetrations of previous points. I can only conclude that the action of January 26, taking both Averages below the December lows, is extremely bearish. On the same day, as a matter of interest, all three major auto stocks (GM, C, F) recorded new low closings, although the previous inter-day low for GM was 65.5. DuPont also broke under 100, inter-day, which I take as a bearish omen. The test of the 1966 lows would seem to lie ahead.